Before the Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554
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In the Matter of	)	
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Review of Section 251 Unbundling	)	CC Docket No. 01-338
Obligations of Incumbent Local	)	
Exchange Carriers	)	
	)	
Implementation of the Local Competition	)	
Provisions of the Telecommunications	)	CC Docket No. 96-98
Act of 1996	)	
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Deployment of Wireline Services Offering	)	CC Docket No. 98-147
Advanced Telecommunications Capability	)	
	)	

Comments of Competitive Enterprise Institute

March 18, 2002

The Competitive Enterprise Institute is a nonpartisan policy analysis organization, dedicated to the principles of limited constitutional government and free enterprise. The Institute is a nonprofit educational foundation. Solveig Singleton, the author of these comments, is a lawyer and senior analyst with the Competitive Enterprise Institute.

Part I of these comments concerns the methodology the FCC will employ in describing a "framework" for its approach to unbundling, particularly for broadband services. We recommend that the FCC do its utmost to reduce political and regulatory risk and uncertainty by focusing on incentives rather than on current market conditions. Part II explores a second core issue in the proceeding, the risk that granting broad long-term access to incumbent local exchange carrier facilities will delay the onset of facilities-based competition. Our comments address the issue of statutory analysis and general approach rather than specific network elements.

I. A "Framework" For Assessing Unbundling

The approach the FCC takes in its Triennial Review Notice is an interesting one. The Commission encourages participants to submit evidence of "actual marketplace conditions" believing it will be "more probative than other kinds of evidence, such as cost studies or hypothetical modeling." While it is certainly true that the Commission's ventures into cost modeling (particularly TELRIC) have arguably caused more problems than they have solved, the Commission's present approach is likely to lead to trouble of a different sort. The Commission may successfully avoid the problems of what Alfred Kahn cheerfully calls TELRIC B.S. while finding itself up to its neck in facts none of which speak for themselves and all of which are likely to be quickly outdated.

The bottom line is, the best approach to the FCC's triennial review of unbundling requirements is a principled approach that relies on market forces, not computers or consultants, to do the work of building competition. This section will describe, not what we know about broadband markets, but what we do not and cannot know about broadband markets... and how this essential ignorance should shape the FCC's approach to its triennial review-in the direction of thinking about incentives, not particular market conditions.

A. Limits on the Current State of Knowledge of Broadband Markets

In considering the import of unbundling policy for broadband, the FCC will have at its disposal a wide range of facts about broadband, including its own data from the third report on the availability of advanced telecommunications services. Data currently available include current penetration rates of cable modem and DSL services, growth rates, prices, and "homes passed" figures from different geographic and demographic groups, and consumer valuations. Telecommunications carriers can be expected to add to this data information about the current costs of providing service, their past and planned investments, capacity and switching capabilities, and so on.

The Commission's notice, however, gives little indication of how the information it will collect on market conditions relevant to its unbundling inquiry might be used. Does it propose to set its policy on the basis of present market conditions? This seems unwise, as market conditions often have a startlingly short shelf life. To orient policy to market conditions seems to doom that policy to obsolescence before the ink is dry; the alternative is for the FCC to issue rules with the expectation of revising them every couple years. If the FCC does plan to do this, it should at least address the shortcomings of this approach; frequent rulemakings chill investment by adding to the climate of uncertainty, and invite political gamesmanship.

Perhaps the FCC seeks data to answer how its policies have helped to shape current market conditions? The point of the Commission's triennial review is to assess its unbundling rules, for example, to consider how those rules might have affected investment. But to answer this question with respect to broadband (for example), the Commission will need, not only data on investment in new and present networks, but data on how much investment might have occurred under a different set of unbundling rules.

It is not wrong for the Commission to wish to discover the current state of markets, and may avoid some types of errors only by doing so. But we hope that the Commission does not believe that the facts will "speak for themselves" in determining policy. They will not. Furthermore, those facts themselves are extremely limited in scope and durability.

B. Should the Commission Undertake More "Refined" Unbundling Rules?

These limits on what any regulator may know are not unique to the present triennial review. But they may become of special significance because some parties have suggested that this proceeding become an extremely ambitious one. As the FCC notes, "parties have suggested other ways to apply the unbundling analysis in a more granular way. . . we probe whether and to what extent we should adopt a more sophisticated, refined unbundling analysis." Indeed, the question is, does the statute contemplate such an approach? For, on one view, what is "necessary" and what will "impair" a given venture will depend on that venture's location, the market, the services it seeks to offer, the

type of facilities, and the customer and characteristics of the requesting carrier. The FCC notes that the benefits of more "refined" unbundling rules along these lines should be weighed against the "administrative burden of conducting the more detailed analysis and applying more complicated rules."

An attempt by the FCC to entangle itself in setting different standards depending on which carrier is offering what service to which type of customer in what market threatens to create more than an "administrative burden." It could well create a nightmare of confusion, delay, litigation, political posturing and gamesmanship. The best solution to this problem might be for Congress to amend the statute so as to make it clear that the FCC should consider the necessity of unbundling a certain element to competition as a whole, not to individual competitors, bringing the unbundling standard more into line with antitrust standards. A standard that requires the FCC to cater to the subjective needs of individual competitors will merely bring a plethora of weak, dependant pseudo-competitors crawling out of the woodwork, few of whom have the resources or intention of building up their own facilities.

Having said this, however, there may be steps the FCC can take account of special circumstances surrounding certain services or types of facilities that would not venture into micromanagement. The following are good candidates:

=B7 New advanced services and facilities should generally be exempt from unbundling rules. The unbundling requirements were intended to help competition grow in the area of voice services, and it is doubtful that Congress intended that they be extended to advanced services such as broadband. If there is any doubt as to whether a facility is a "new service," the presumption should be that it will not be unbundled.
=B7 Under some circumstances, disputes surrounding the appropriateness of the application of unbundling rules could be booted into fast-track arbitration. This would allow such disputes to be resolved with minimal delays and resorts to the political process.
=B7 Periodically (perhaps in the triennial review), the FCC might describe circumstances in which unbundling rules will no longer be applied. For example, in this proceeding, the FCC might take this occasion to rule on the issue of whether ILECS should be required to offer unbundling to carriers that have their own facilities, including wireless carriers.

In considering how finely to perform its more "granular" statutory analysis, the Commission should not forget its own histories of fallibility and delay. Micro-managing telecommunications markets is more likely than ever to backfire as applied to new services like broadband. But if the FCC takes account of special circumstances to pull back from micro-management of unbundling as a part of an ongoing process, it may have some benefits. But the focus should be on incentives-not on specific market conditions.

The difference between the two approaches is this. The FCC, on the one hand, may choose to engage in intensive, fact-specific inquiries into different geographic markets or particular services in the hope of guaranteeing competitive outcomes or, worse, helping certain individual competitors. This is unlikely to be successful. It is inappropriate to impose arbitrary cost models as normative standards on real markets. But it is equally inappropriate to substitute for those arbitrary cost models the very fallible judgments of a group of Commissioners on a case-by-case basis. On the other hand, the FCC may use this occasion to

take a step back from micromanagement, recognizing that too-broad application of unbundling rules has its costs in discouraging investment and adding to regulatory burdens, and recognize some general principles under which the rules should be scaled back. The Commission may choose to focus on creating the right incentives rather than guaranteeing certain economic outcomes in the short run.

This, in our view, is the central methodological issue of this proceeding. In the next section, we consider the central substantive issue.

Part II. More On Incentives: Competition, Facilities-Based Competition, and Investment

After several decades of interconnection, resale, and unbundling proceedings across various markets and the growth of various types of competitors, we may generalize as follows. First, forced unbundling and resale has remained the dominant strategy for addressing perceived residual monopoly issues in the local exchange. It is not, however, the only strategy that might be tried. Lifting price controls in residential areas might be more effective, if the success of competitive carriers in entering the higher-priced business markets is any indicator. The forced unbundling policy seems to have been chosen mainly because the alternative of lifting price controls is not politically viable. This should not, however, blind us to the merits of rate rebalancing-perhaps most relevant in considering a role for the states. Nor should it blind us to the costs of forced unbundling.

Now we come to the central substantive issue of this proceeding, which the FCC raises in a number of ways in its Notice. That is, does unbundling actually foster competition (as opposed to a myriad weak competitors)? Or does it prolong reliance on legacy networks by discouraging investment in new facilities? To raise the same issue another way, what kind of competition do we want? Competition between different services and content providers? Or competition between different types of facilities and access? Or, as the Notice puts it, "is it equally beneficial to encourage investment in transmission facilities as in switching facilities?" Should the FCC encourage the development of a wholesale market?

A. The Relation Between Investment and Unbundling Rules.

A great deal of ink has been expended on the question of whether unbundling rules priced in this or that manner discourage investment. Some analysts have argued that there is no empirical evidence of such effects. This argument presents a bit of a puzzle; presumably, the best empirical evidence would consist of information about what investment would have been in the absence of the rules, data that could never be collected. But unbundling is just another instance of price regulation. It can be expected to have the same impact on investment as any other type of price regulation.

In most regulatory inquiries in telecommunications, the inquiry next proceeds to consider where the price of the unbundled elements should be set to avoid such effects. We wonder only why, if this process works so well, it has not been adopted for the rest of the economy?

For those who are not good at getting the point of rhetorical questions, it is because the process does not work well; in telecommunications, it is perhaps a necessary evil. But there has been a great deal of stress on the necessary, and very little on the evil. Perhaps in this unbundling proceedings, it would be good to re-examine the necessity, and remember the evil. Particularly when

newer and more advanced services such as broadband are concerned.

B. The Nature of Broadband Markets. There is a great deal we do not know about broadband. Here is an outline of what we do know. we are at the very beginning of an evolutionary process. Residential interest in subscribing to the first generation of broadband is low at the current usual price of $40 to $50 dollars per month. Some kind of high-speed access-cable, enhanced telephone access known as DSL, or satellite-- is available to about 80 percent of homes in the country. But only about 10 percent of residential consumers have signed on. Even when the price is much lower, not everyone is interested. In one trial in LaGrange, Georgia, only half of those in a community offered free broadband signed up. There's still no "killer app" for broadband. When the "killer app" for broadband content does come, what will it look like? A nostalgic look back at what has drawn consumers to new tech devices in the past suggests that politicians may get a surprise-or a shock. The growth of the VCR was, after all, substantially due to the attraction of adult movies. Sex sites were some of the first to make money on the Web, too.

The most sophisticated and determined consumers of broadband among residential users so far are those addicted to interactive online games. The growth of broadband will be stop and start, try and fail, incremental, boom and bust-like every other successful economic experiment. Or perhaps the secret to offering must-have broadband content is to appeal to many niche markets, not the anonymous masses. No one knows yet for sure.

In the face of this reality, any broadband venture is as likely to fail as not, just as Excite@Home collapsed. Not only do entrepreneurs not know what content is most likely to sell, but no one knows what combination of network features and content are likely to be most appealing. When and if the "killer app" does come, what speed does it need? What type of switching architecture? What price plan? The investment risk and uncertainty is enormous simply because of uncertainties on the demand side. And that is just the beginning.

In this environment, it would be perhaps overly ambitious for regulators to attempt to foster or discourage "wholesale" markets except by staying out of the way of those who wish to provide them. Remember the FCC's disastrous attempts to foster open video services and video dialtone. Recall, also, the failure of the FCC's TELRIC pricing and unbundling models to make offering wholesale services an attractive business for ILECS thus far.

It would also be a mistake for the FCC to try to favor competition in switching over competition in transmission, or, for that matter, competition between different content providers over competition between different facilities-based competitors. The market will decide.

In this environment, broadband will grow most quickly when players are given maximum freedom to deploy their resources so as to reap the maximum rewards at their own risk. Notice-they should be able to deploy their own resources at their own risk-not someone else's. In this environment, unbundling, with its tendency to create a plethora of weak competitors that are dependant on regulatory processes and machinery, should intrude as little as possible.

C. Drawing the Line: Where to Cut Off Unbundling?
The observation that unbundling rules can deter investment suggests that the expansion of such rules should be limited, particularly to advanced services such as broadband. But this raises several questions addressed

in the notice. Exactly where is the cutoff point between services that should be considered "new" and thus sheltered from unbundling rules? The answer is, there really is no "right" answer to this question in most cases. Wherever this line is drawn, it will create some regulatory arbitrage. What matters most is that the line be drawn somewhere-and not subject to being continually redrawn. There are several ways to draw such lines, each with its own drawbacks.

One of the clearest ways is by using dates. Facilities built after certain date will not be unbundled. This has the drawback of perhaps "rewarding" certain types of delays until the date in question comes up. But there are solutions to this problem, such as sending disputes into fast-track arbitration.

An alternative would limit the availability of unbundling to competitors that have been operating as facilities-based carriers for a certain number of years. The FCC has used this rule in the past. In the early 1990's, the FCC ruled that it would no longer require a facilities?based cellular telephone service provider to provide resale capacity to a fully operational facilities?based competitor in the same market. The FCC's concern was that extensive resale rights were enabling cellular carriers to defer making capital expenditures to expand their own networks. The FCC allowed a cellular licensee to deny resale capacity to its facilities-based competitor in the same market after the competitor has been operating for five years.

Another bright line might be drawn between different types of services. Those providing "broadband" services, however defined, for example, might be sheltered from unbundling. This may have the drawback of chopping off innovation in anything considered "narrowband." But this danger may be minimized by reexamining the unbundling rules on the "narrowband" side to ensure that they are scaled back as needed.

The rule of thumb in choosing a dividing line is that it should be sufficiently certain over time so that parties may rely on it in planning their investment behavior. Disputes over how to apply the rule should be sheltered to as great an extent possible from the political process-that is, from being revisited at the FCC. The best way to do this may be to send disputes into arbitration. And if investments are sheltered from unbundling on one side of the dividing line, this should not be an excuse for neglecting to re-examine unbundling rules on the regulated side of the line. The lighter the regulatory burden on the regulated side, the less regulatory arbitrage there will be between the two.

Conclusion

For many years, unbundling and resale has been the solution of first and last resort in addressing problems of market power in the local exchange. As with any other price regulation, however, unbundling rules are likely to deter investment. In its triennial review, the FCC should focus on revising its rules so as to maximize incentives to encourage players to invest their own resources in new networks-rather than allocating resources by attempting to fine-tune fallible and slow regulatory processes. The best place for the FCC to proceed with this strategy is in the area of broadband, where regulatory knowledge is limited, entrepreneurial risk is high, and consumer demand is eccentric. Business planners need certain rules to minimize political risk, and flexibility to minimize their business risk. The FCC's triennial review is a good place to start.

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